

Why the New U.S. Tariffs on Steel Could Be a Pandora's Box

Ryan Bourne

March 14, 2018

President Trump's plan to impose import tariffs on steel and aluminum has provoked righteous anger from the EU. The Commission wants to respond with targeted tariffs on US goods such as motorcycles, jeans, and bourbon whiskey—tradeables with major producers in GOP areas. The thinking? To put maximum political pressure on Republicans to change Trump's mind.

Early indications suggest though that this strategy is doomed to fail. Yesterday's resignation of President Trump's top economic advisor Gary Cohn (a free trader, who was organizing downstream manufacturers to lobby to dissuade the President) is as good a leading indicator as any that the President's mind is set. Today, US Secretary to the Treasury Steve Mnuchin has reportedly confirmed tariffs will happen. And if the EU goes ahead with its "proportionate response"? Well, Trump says he's ready for more tariffs, this time on EU cars. An import tax arms race becomes an out-and-out trade war pretty quickly.

The "National Security" Excuse

The spectacle is rather depressing. As my colleague Dan Ikenson has outlined, in isolation Trump's tariffs would not be that economically significant. After all, the EU imposes over 12,500 tariffs of its own, some of which are high. But Trump's use of a "national security" justification and his broader gunboat diplomacy threatens to open a Pandora's Box of global risks and retaliation.

Instead of goading Trump with punishment tariffs and rejecting his "national security" argument out of hand, the EU should do, well, nothing.

Of course, the President's reasoning for protectionism is not sound. Given the origins of US imported steel includes major military allies, a "national security" justification is absurd. By increasing the input prices for downstream producers, tariffs on steel and aluminum are a wanton act of domestic self-harm. And all this to notionally "protect" jobs in two industries, when independent economic analysis suggests each extra job "saved" in these sectors would cost five times more lost in others, with a net loss of 146,000 jobs overall.

As dangerous as President Trump's policy undoubtedly is, any game theorist will tell you that under the assumption of commitment to this course—or worse—the optimum strategy for the EU changes. Tit-for-tat retaliation risks exacerbating the economic pain at an already precarious moment and taking us to a mutually destructive equilibrium. Instead of goading Trump with punishment tariffs and rejecting his “national security” argument out of hand, the EU should do, well, nothing. At least not on tariffs.

No Need for Escalation

This sounds counterintuitive. If a trade war is underway, shouldn't the EU, as a major player, bring its big guns to town? No. Politicians may enjoy the military analogy. But in actual wars, countries try to blockade rivals, to prevent the goods wanted and needed by adversaries from reaching their shores. In trade wars, in contrast, tariffs are a form of economic blockade on ourselves. They are in effect like a suicide bomb—saying we will risk economic self-harm to cause some damage to your producers if you choose that path too. Yet, if the US is hell-bent on damaging itself economically come what may, then is it really worth the self-inflicted damage?

In trade, two wrongs really don't make a right. But they do make less dynamic economies.

Put another way, in most (though not all) economic situations, the primary losers from the imposition of tariffs are actually domestic consumers. Yes, US producers of bourbon and jeans will dislike EU tariffs on US imports. But EU consumers will face the higher prices resulting, and the loss of economic welfare from not buying products they value more highly. Tariffs on popular goods would be fighting stupid with stupid, destroying value creation. If Trump's decision is truly fixed, the best course of action for overall economic health is to not retaliate.

In trade, two wrongs really don't make a right. But they do make less dynamic economies. Producers operate facing the prices in front of them and allocate resources to seek the most profitable ventures. But domestic tariffs distort these price signals, diverting resources away from sectors where we hold a comparative advantage and instead placing them in sectors insulated from global competition. All this worsens economic performance further and lowers productivity.

Take the High Road

Here, the EU talks a good game about the costs of trade wars. But if it truly values free trade and the rules-based trading system, then now is the time to take the high ground. If the President wants to whack US consumers of steel and aluminum and distort US economic activity to less-productive sectors, then that's his problem. If he wants to abandon and undermine the global trading system then more's the pity. But the EU need not hit its consumers too. Nor should the EU help hasten the decline of global rules using targeted tariffs and refusing to acknowledge that, as thin as the justification is, the national security loophole exists.

The best way of preventing a trade war is to choose peace.

No, instead of throwing more fuel on the protectionist fire, it should reach out to Trump and push for multilateral action at a WTO level to counter genuine anti-competitive trade distortions in

these industries. Better, it should acknowledge that its own Common External Tariff is corrupted by its own blatant protectionism—something President Trump uncomfortably highlighted in regard to cars yesterday. The EU should expect foreign countries to do as they do, and not as they say, after all.

None of this should be taken as an apology for the President's action. His justifications are unprecedented and clearly a veneer for a narrow, misguided effort to protect favored sectors. But faced with a bombastic, volatile actor with a penchant for tariffs, the EU now faces a choice: a risky path of escalation, including self-harm, or to accept the limited damage of Trump's tariffs on two relatively small sectors.

The best way of preventing a trade war is to choose peace. One hopes in this moment, the EU will really believe its own arguments.

Ryan Bourne occupies the R. Evan Scharf Chair for the Public Understanding of Economics at Cato. He has written on a number of economic issues, including: fiscal policy, inequality, minimum wages and rent control. Before joining Cato, Bourne was Head of Public Policy at the Institute of Economic Affairs and Head of Economic Research at the Centre for Policy Studies (both in the UK)